FILE COPY

No. 341

In the Supreme Court of the United States

OCTOBER TERM, 1937

DAVID BURNEY, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

GORONADO OIL AND GAS COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE DISTRICT OF COLUMBIA AND BRIEF IN SUPPORT THEREOF

INDEX

	Page
Petition:	
Question presented	1
Statutes involved	2
Statement	2
Specification of error to be urged	3
Reasons for granting the writ	3
Brief in support of petition:	
Opinions below	6
Jurisdiction	6
Question presented, statutes involved, etc	6
Argument	6
Conclusion	13
Appendix	14–18

CITATIONS

Cases:	
Alward v. *Johnson*, 282 U. S. 509	8
Ambrosini v. *United States*, 187 U. S. 1	10
Baltimore Shipbuilding Co. v. *Baltimore*, 195 U. S. 375	5, 8
Bear Canyon Coal Co. v. *Commissioner* (App. D. C.), No. 5051	4
Central Pacific R. R. Co. v. *California*, 162 U. S. 91	10
Choctaw, O. & G. R. R. Co. v. *Mackey*, 256 U. S. 531	9
Cincinnati v. *Lewis, Auditor*, 66 Oh. St. 80	12
Flint v. *Stone Tracy Co.*, 220 U. S. 107	10
Forbes v. *Gracey*, 4 Otto, 762	4, 7, 13
Gillespie v. *Oklahoma*, 257 U. S. 501	5, 12
Green v. *Frazier*, 253 U. S. 233	11
Gromer v. *Standard Dredging Co.*, 224 U. S. 362	5, 8
Group No. 1 Oil Corporation v. *Bass*, 283 U. S. 279	4
Jaybird Mining Co. v. *Weir*, 271 U. S. 609	12
Lucas v. *Howard*, 280 U. S. 526	8
Lucas v. *Reed*, 281 U. S. 639	8
Manhattan Co. v. *Blake*, 148 U. S. 412	10
Marland, Ernest Whitworth v. *United States* (C. Cls.), No. K322	4
Metcalf & Eddy v. *Mitchell*, 269 U. S. 514	5, 7, 10, 12
National Bank v. *United States*, 101 U. S. 1	10

Cases—Continued. Page

North Dakota v. Olsen, 33 F. (2d) 843, dismissed for lack of jurisdiction, 280 U. S. 528 11

Railroad Co. v. Peniston, 18 Wall. 5 9

Salt Lake City v. Hollister, 118 U. S. 256 11

School District of Ft. Smith v. Howe, 62 Ark. 481 11

Shaw v. Gibson-Zahniser Oil Corp., 276 U. S. 575 9, 12

Snyder v. Robinson, 190 U. S. 249 10

South Carolina v. United States, 199 U. S. 437 8, 10

Thomas v. Gay, 169 U. S. 264 9, 12

Thomson v. Pacific R. R. Co., 9 Wall. 579 9

Veazie Bank v. Fenno, 8 Wall. 533 10

Wagoner v. Evans, 170 U. S. 588 12

Willoutte v. Bunn, 282 U. S. 216 8, 12

Statutes:

Act of June 16, 1906, c. 3335, 34 Stat. 267, 270, 272, 273—

Sec. 5 2, 15

Sec. 7 2, 15

Sec. 8 2, 15

Oklahoma Compiled Statutes of 1921—

Sec. 9415 2, 16

Sec. 9417 2, 17

Sec. 9423 2, 17

Revenue Act of 1916, c. 463, 39 Stat. 756—

Sec. 10 14

Sec. 11 14

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1065, 1077—

Sec. 213 14

Sec. 235 14

Miscellaneous: Constitution of Oklahoma, Article XI, Sec. 1 2, 16

In the Supreme Court of the United States

OCTOBER TERM, 1931

No. —

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, petitioner

v.

CORONADO OIL AND GAS COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE DISTRICT OF COLUMBIA AND BRIEF IN SUPPORT THEREOF

PETITION

The Solicitor General, in behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Court of Appeals of the District of Columbia entered in the above case June 1, 1931 (R. 131), reversing the decision of the United States Board of Tax Appeals (R. 66).

QUESTION PRESENTED

May the United States constitutionally impose a tax upon the income of a private corporation de-

rived from sales of oil and gas produced under lease of lands owned and set apart by the State of Oklahoma for the maintenance of its common schools?

The statutes involved are set forth in the appendix, pp. 14–18, *infra*.

STATEMENT

By the Oklahoma Enabling Act Congress required, as a condition of admission into the Union, that the State should make provision in its constitution for a system of common schools, and for this purpose granted to the State sections in every township, with the proviso that such lands valuable for minerals should not be sold but might be leased for periods of five years, the proceeds to be paid to the school fund. Act of June 16, 1906, Sections 3, 7, and 8 (c. 3335, 34 Stat. 267, 270, 272, 273), p. 15, *infra*. The State, by its constitution, provided for a common-school system, and pledged its faith to preserve the lands and moneys derived from them as a "sacred trust" for the purposes for which the lands were granted. Constitution of Oklahoma, Article XI, Section 1, p. 16, *infra*. Legislative provision was then made for leasing the lands containing gas and oil, and for the payment of the proceeds into the school fund. Oklahoma Compiled Statutes 1921, Sections 9415, 9417, and 9423, pp. 16–18, *infra*.

The State leased certain lands to respondent, an Oklahoma corporation, in January, 1914, re-

making the leases (on somewhat different terms) in May, 1918. (R. 97–103.) Respondent agreed to pay the State under the first lease 50 per cent, and under the second lease 12½ per cent, of the gross production of oil and gas. (R. 97, 98.)

The Commissioner of Internal Revenue assessed income taxes upon respondent's income derived through the sale of its share of the oil and gas obtained from the leased lands during 1917, 1918, and 1919. The Board of Tax Appeals sustained the action of the Commissioner. (R. 66; 14 B. T. A. 1214.) The Court of Appeals of the District of Columbia (Martin, C. J., dissenting) reversed the decision of the Board. (R. 124.)

SPECIFICATION OF ERROR TO BE URGED

The Court of Appeals erred in holding that the United States was without power to tax respondent's income derived from the sale of respondent's share of oil and gas produced under lease of lands owned by the State of Oklahoma and set apart for the maintenance of its common schools.

REASONS FOR GRANTING THE WRIT

This case involves the extent of the implied constitutional limitation upon the power of the United States to tax agencies or instrumentalities of the States, and particularly the question whether income from sales made by a private corporation of oil taken from lands leased from a State is exempt from Federal taxation. It is common knowledge

that many States lease large tracts of State lands to private parties; that such leases are sought in the expectation of profit from the sale of ore, coal, oil, and other valuable products of the land; and that the recovery and sale of such products under leases of State lands often result in very substantial profits to the lessees. The exemption from Federal taxation of profits derived by the lessees of State lands materially affects the revenue of the United States and the case is of general importance in the administration of the Federal taxing statutes.[1]

The precise question has never been decided by this Court. It was presented and argued in *Group No. 1 Oil Corporation* v. *Bass*, 283 U. S. 279. But decision in that case was predicated upon rulings of the Supreme Court of Texas to the effect that the lease there in question was a sale of oil and gas in place. The issue is now pending before the Court of Claims in *Ernest Whitworth Marland* v. *United States*, No. K–322 (Oklahoma State oil lands), and is also before the Court of Appeals of the District of Columbia in *Bear Canyon Coal Co.* v. *Commissioner*, No. 5051 (Colorado State coal lands).

We believe the decision below is contrary to the ruling of this Court in *Forbes* v. *Gracey*, 4 Otto, 762,

[1] We have been informed by the Treasury Department that it estimates, basing such estimate on the value of oil royalties received by the States of New Mexico, Oklahoma, and Texas, that taxes aggregating about twelve million dollars are involved annually in those three States, that such sum would be increased by an increase in the price of oil, and that until decided the question here involved will arise continually from all States where public lands are leased for oil and gas production purposes.

and a departure from the principles laid down by this Court in *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514; *Gromer* v. *Standard Dredging Co.*, 224 U. S. 362; *Baltimore Shipbuilding Co.* v. *Baltimore*, 195 U. S. 375, and the cases following them, many of which are cited in the brief; and that it is the result of a misapplication of the decision of the Court in *Gillespie* v. *Oklahoma*, 257 U. S. 501.

Wherefore it is respectfully prayed that the petition be granted.

THOMAS D. THACHER,
Solicitor General.

AUGUST, 1931.

BRIEF IN SUPPORT OF PETITION

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 27) is reported in 14 B. T. A. 1214. The opinion of the Court of Appeals of the District of Columbia (R. 124) is not yet reported.

JURISDICTION

The judgment of the Court of Appeals was entered June 1, 1931. (R. 131.) Jurisdiction is conferred upon this Court by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED, STATUTES INVOLVED, ETC.

A statement of the question presented, specification of error, and a statement of the case will be found in the petition. The statutes involved appear in the appendix.

ARGUMENT

The United States here asserts the right to tax the income of a private corporation organized and operated solely for private profit. Respondent resists the claim on the ground that it is within the protection of the implied constitutional limitation

upon the power of the Federal government to tax instrumentalities of the States.

The contention that the respondent is an instrumentality of the government of Oklahoma finds its sole support in the fact that the State has entered into a business transaction with it. Cases are numerous where private profits more immediately connected with the business of government have been held by this Court to be within the reach of the taxing power.

In *Forbes* v. *Gracey*, 4 Otto, 762, it was held that Nevada might impose a tax on the proceeds of a mine, although the mine itself was the property of the United States and was worked by the taxpayer under a mining claim held from the United States.

In *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514, it was held that fees of a consulting engineer received for services in advising a State or local subdivision as to sanitary projects were subject to the Federal income tax, because this Court could not find that the tax impaired in any substantial manner the ability of the plaintiffs in error to discharge their obligations to the State or the ability of the State to procure the services of private individuals to aid them in their undertakings; and it said, at page 522:

> * * * it is apparent that not every person who uses his property or derives a profit, in his dealings with the government, may clothe himself with immunity from taxa-

tion on the theory that either he or his property is an instrumentality of government within the meaning of the rule.

See also *Lucas* v. *Reed*, 281 U. S. 699, and *Lucas* v. *Howard*, 280 U. S. 526. In *Gromer* v. *Standard Dredging Co.*, 224 U. S. 362, this Court held that Porto Rico might tax machinery and boats engaged in dredging work in San Juan harbor in pursuance of a contract with the United States government. In *Baltimore Shipbuilding Company* v. *Baltimore*, 195 U. S. 375, it was held that a State might tax the interest of a company owning a dry dock in land conveyed to it by the United States, notwithstanding a provision in the instrument of conveyance that upon certain contingencies the property might revert to the United States, and that the United States had a continuing interest to use the dry dock to serve its purposes. In *South Carolina* v. *United States*, 199 U. S. 437, it was held that the Federal government might exact a license tax from dispensers operating liquor dispensaries established by the State of South Carolina.

In *Alward* v. *Johnson*, 282 U. S. 509, it was held that a State might levy a gross receipts tax upon the franchises and property of a bus line, although three-fourths of its revenues were earned by carrying the United States mail. In *Willcuts* v. *Bunn*, 282 U. S. 216, it was held that the United States could impose a tax upon a profit derived from a

sale by a private owner of municipal and State bonds.

In *Shaw* v. *Gibson-Zahniser Oil Corporation*, 276 U. S. 575, it was held that the State of Oklahoma might impose a tax on the gross value of oil and gas produced, although such oil and gas were produced by the taxpayer under a lease of lands owned by an Indian, and inalienable by him without the consent of the Secretary of the Interior. In *Choctaw, O. & G. Railroad Company* v. *Mackey*, 256 U. S. 531, it was held that an Oklahoma municipality might levy a special assessment for street improvements against part of the right of way and station ground of a lessee railroad company whose lessor was a corporation to which Congress had granted the right to build a railroad in Indian Territory with a branch line to coal mines leased from the Choctaw Nation. In *Thomas* v. *Gay*, 169 U. S. 264, it was held that an Oklahoma county might tax cattle grazing on Indian lands under certain leases for grazing purposes made by the Osage tribal government subject to the ratification of the Commissioner of Indian Affairs and of the Secretary of the Interior.

In *Thomson* v. *Pacific Railroad Co.*, 9 Wall. 579, it was held that a State might tax property of a railroad corporation which had been the recipient of benefits by way of subsidy from the United States, and which was bound to perform certain services for the United States. In *Railroad Company* v. *Peniston*, 18 Wall. 5, it was held that Line

coln County, Nebraska, could tax the Union Pacific Railroad Company on its property in the County, although the railroad company was a Federal corporation chartered for the purposes, among others, of carrying the mails, of transporting troops and supplies, and of performing other services for the United States. See also *Central Pacific Railroad Company* v. *California*, 162 U. S. 91.

In *Veazie Bank* v. *Fenno*, 8 Wall. 533, this Court upheld a tax on notes issued by a bank operating under a State franchise. In *National Bank* v. *United States*, 101 U. S. 1, a tax on notes issued by a municipality and used as money was upheld. In *Manhattan Co.* v. *Blake*, 148 U. S. 412, it was held that a Federal tax on the average deposits of a bank was not unconstitutional by reason of the fact that there were included moneys deposited by the treasurer of the State of New York. In *Snyder* v. *Bettman*, 190 U. S. 249, a succession tax on the transfer of property by will to a municipality was upheld.

The implied prohibition upon the United States extends only to exertions of State power of a strictly governmental nature. *South Carolina* v. *United States*, *supra*, p. 461; *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, 157–158; *Ambrosini* v. *United States*, 187 U. S. 1, 7. And coupled with this is the condition that absolute immunity from Federal taxation exists only in favor of those State agencies which themselves immediately and directly execute such power. *Metcalf & Eddy* v. *Mitchell*, *supra*, p. 522.

It need not be argued that respondent's production and sale of gas and oil were not acts of government. They were merely activities incident to the carrying on of an ordinary private business. Neither their performance nor the making of the lease between respondent and the State was immediately and directly connected with the operation of the schools.

The use to which the State put the revenue it derived from the lease did not change the character of these acts from that of private business to that of sovereignty or government. The nature of an act as governmental or nongovernmental is determined by what it is in and of itself, not by what the profits it produces may be devoted to. In the *South Carolina case, supra,* the gains were paid into the public coffers to help support the ordinary activities of government, yet it was there held that persons selling liquor in dispensaries set up by the State itself were taxable by the United States; and it seems apparent that leasing oil land is no more governmental in character than the operation of dispensaries. See also *Salt Lake City* v. *Hollister,* 118 U. S. 256. Profits earned by the State bank were turned over to the treasurer of the state of North Dakota (see *Green* v. *Frazier,* 253 U. S. 233, 235); yet the bank was held subject to the Federal capital stock tax. *State of North Dakota* v. *Olson* (C. C. A. 8th), 33 F. (2d) 848, dismissed for lack of jurisdiction, 280 U. S. 528. See also *School Dis-*

trict of Ft. Smith v. *Howe*, 62 Ark. 481, 485–486; *Cincinnati* v. *Lewis, Auditor*, 66 Oh. St. 49.

The tax in question must be sustained unless its effect is to cast a substantial burden on the State's operation of its schools. It is no more burdensome than that approved in *Metcalf & Eddy* v. *Mitchell, supra.* The State's efficiency in performing its governmental functions is not impaired. *Metcalf case, supra*, pp. 524–525. See *Thomas* v. *Gay*, 169 U. S. 264, 273; *Wagoner* v. *Evans*, 170 U. S. 588, 591; *Willcuts* v. *Bunn, supra*, pp. 230–231.

The Court of Appeals thought it was controlled by the decisions of this Court in *Gillespie* v. *Oklahoma*, 257 U. S. 501, and *Jaybird Mining Company* v. *Weir*, 271 U. S. 609. We think that the Court of Appeals gave insufficient weight to the many cases mentioned above in its endeavor to fit the present case into what it conceived to be the rule of the *Gillespie* case. That case must rest upon the unique relationship of the United States to its Indian wards, and the purpose of Congress to provide for their welfare by setting apart by allotment or otherwise tribal lands or the public domain restricted for their benefit. Such considerations as these, peculiar to restricted, allotted, or tribal lands of the Indians, led to the conclusion that neither leases of such lands nor their exploitation by the lessee, nor his income therefrom, may be taxed by the State. (*Shaw* v. *Oil Corporation*, 276 U. S. 575.) But these exemptions, thus extended to lessees of tribal and allotted Indian lands, can not

be extended to the lessees of other Government lands (*Forbes* v. *Gracey*, 4 Otto, 762), and if, as this Court has held in the *Gracey case*, the value of the gross product of a mining claim on Government lands can be subjected to State taxation, certainly the income derived by a lessee of State lands from the sale of such products may be subjected to Federal taxation. The effect of the *Gillespie case*, we submit, is not to impair the doctrine of the many cases in which this Court has held that profits arising from dealings with the State are not exempt from the general tax upon all income.

CONCLUSION

The question involves the constitutional power of the Federal Government to tax income derived by lessees of State lands, and is of equal importance in its effect upon the power of the State to tax such income derived from Government lands. We respectfully submit that the petition should be granted.

THOMAS D. THACHER,
Solicitor General.
G. A. YOUNGQUIST,
Assistant Attorney General.
WHITNEY NORTH SEYMOUR,
J. LOUIS MONARCH,
HAYNER N. LARSON,
Special Assistants to the Attorney General.
FRANCIS H. HORAN,
Attorney.

AUGUST, 1931.

APPENDIX

Revenue Act of 1916, c. 463, 39 Stat. 756:

SEC. 10. That there shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding calendar year from all sources by every corporation, joint-stock company or association, or insurance company, organized in the United States, no matter how created or organized but not including partnerships, a tax * * *.

SEC. 11. (b) There shall not be taxed under this title any income derived * * * from the exercise of any essential governmental function accruing to any State * * *.

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1065, 1077:

SEC. 233. (a) That in the case of a corporation subject to the tax imposed by section 230 the term "gross income" means the gross income as defined in section 213, * * *.

SEC. 213. That for the purposes of this title * * * the term "gross income"—

(a) Includes gains, profits, and income derived * * * from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

Act of June 16, 1906, c. 3335, 34 Stat. 267, 270, 272, 273:

SEC. 3. Fifth. That provisions shall be made for the establishment and maintenance of a system of public schools, which shall be open to all the children of said State and free from sectarian control; * * *.

SEC. 7. That upon the admission of the State into the Union sections numbered sixteen and thirty-six, in every township in Oklahoma Territory, and all indemnity lands heretofore selected in lieu thereof, are hereby granted to the State for the use and benefit of the common schools: * * *.

There is hereby appropriated, out of any money in the Treasury not otherwise appropriated, the sum of five million dollars for the use and benefit of the common schools of said State in lieu of sections sixteen and thirty-six, and other lands of the Indian Territory. * * *

SEC. 8. * * *

Where any part of the lands granted by this Act to the State of Oklahoma are valuable for minerals, which terms shall also include gas and oil, such lands shall not be sold by the said State prior to January first, nineteen hundred and fifteen; but the same may be leased for periods not exceeding five years by the State officers duly authorized for that purpose, such leasing to be made by public competition after not less than thirty days' advertisement in the manner to be prescribed by law, and all such leasing shall be done under sealed bids and awarded to the highest responsible bidder. The leasing shall require and the advertisement shall specify in each case a fixed royalty to be paid by the successful bidder, in addition to any bonus offered for the lease, and all pro-

ceeds from leases shall be covered into the fund to which they shall properly belong, and no transfer or assignment of any lease shall be valid or confer any right in the assignee without the consent of the proper State authorities in writing: * * *.

Constitution of Oklahoma, Article XI:

SECTION 1. *State Accepts All Grants.*—The State hereby accepts all grants of land and donations of money made by the United States under the provisions of the Enabling Act, and any other Acts of Congress, for the uses and purposes and upon the conditions, and under the limitations for which the same are granted or donated; and the faith of the State is hereby pledged to preserve such lands and moneys and all moneys derived from the sale of any of said lands as a sacred trust, and to keep the same for the uses and purposes for which they were granted or donated.

Oklahoma Compiled Statutes of 1921:

SEC. 9415. *Commissioners to segregate public land containing oil and gas.*—When any tract of the school or other public lands, granted to the State of Oklahoma under the act of congress known as the "Enabling Act" is known by the commissioners of the land office of the State to contain oil or gas, or where such lands are, by said commissioners, deemed valuable for oil and gas purposes, such commissioners shall enter of record in their office their finding, declaring that such oil or gas character exists, and further declaring that the oil and the gas deposits are segregated from the surface use and interest therein, and such segregation of such deposits shall conclusively withhold the

same from sale, lease, or other alienation, except as provided in this article.

SEC. 9417. *Lease of oil and gas interest.*—The oil and gas interest described in this article in such lands may be leased by the commissioners of the land office for oil and gas purposes to the same extent and in the same manner as a private owner of lands in fee could, in his own right, execute a grant thereto, subject, however, to the following limitations:

First. For a period not exceeding five years, with suitable provisions for preference right to release for a second term of five years at its expiration, at the maximum rate of rentals, royalties, and bonuses that may be obtained therefor, at the time of such renewal.

Second. Upon due advertisement and public notice of not less than thirty days, in such manner as the commissioners may, by rule, prescribe.

Third. Such leasing shall be done under public bids and awarded to the highest responsible bidder: Provided, that the commissioners of the land office shall have power to reject any and all bids.

SEC. 9423. *Disposition of funds from oil and gas lands.*—The proceeds derived in bonuses and royalties and from other inducements and considerations for the execution and operation of the oil and gas leases in this article provided, shall be carried in the several funds, for the use and benefit of which such lands were granted by the United States to the State of Oklahoma, and to the territory now comprising the area embraced within the said State, under the provisions of the enabling act, and any and all other acts of Congress, for the uses and purposes,

and upon the conditions, and under the limitations for which the same were granted; and the money resulting from such lease and from the operation thereof shall be handled, disposed of and used in like manner as the other moneys belonging to said several funds under the laws of this State.

U. S. GOVERNMENT PRINTING OFFICE: 1926